Roll No. ....

Final New Syllabus
Paper - 6 F
Multidisciplinary Case Study

Total No. of Case Study Questions – Total No. of Printed Pages – 32

Time Allowed – 4 Hours

NOV 2018

Maximum Marks – 100

LASN

Answers to questions are to be given only in English except in the case of candidates who have opted for Hindi Medium. If a candidate who has not opted for Hindi Medium, his/her answers in Hindi will not be valued.

The Question Paper comprises three case study questions. The candidates are required to answer any two case study questions out of three.

Answers in respect of Multiple Choice Questions are to be indicated in capital letters i.e., A or B or C or D as the case may be.

Notes :

(1) Working Notes should form part of the answer. However, in answers to objective type questions (MCQs carrying two marks each), working notes are not required.

(2) Wherever necessary, suitable assumptions may be made by the candidates and disclosed by way of a note.

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QUESTION NO : 1

Background

You are the Chief Financial Officer (CFO) of Tom & Tinken Limited, an Infrastructure Company specializing in various fields such as buildings, dams, bridges, airports, power plants etc. You have taken over this role after having a successful tenure of about 15 years in Wisdom Constructions Limited, who is the direct competitor to Tom & Tinken Limited. Timing of your entry in Tom & Tinken Limited is very crucial especially since the previous CFO, Mrs. Ramamani, has resigned due to personal reasons in the middle of the year-end financial audit process and the Company has recently appointed M/s. Jags & Raghav Associates, Chartered Accountants, as the auditors of the Tom & Tinken Ltd. for a period of 5 years in view of the audit rotation requirements stipulated under the Companies Act, 2013.

The management has very high expectations from you regarding the role you need to play in contributing to Tom & Tinken Ltd. given the timing as well as the multiple challenges impacting the organization with respect to financial reporting. The following key priorities for you have been spelt out by the management;

- Transform the Finance Team
- Ensure smooth completion of the audit
- Maximize the shareholder's value
- Ensure Zero non-compliance with Regulatory requirements

To better understand your role and the team, you have started your journey by interacting with various personnel in the company and collected certain valuable inputs.

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Company Profile

Tom & Tinken Limited is a listed company which has a tremendous track record of showing consistent business growth and is one of the key companies closely monitored by the Analysts and other shareholders. It has 3 subsidiaries in America, Asia and also in Africa and one joint venture in Dubai. It also has an insignificant trading activity relating to certain construction machinery spares which is primarily exported to European market.

The company is professionally managed and various financial institutional investors are holding about 40% of the overall equity share capital of the company. The company has a vibrant leadership team lead by Mr. Prasanna Pai, who is the Chief Executive Officer (CEO), an MBA from Indiana Institute of Management. He is very action oriented and is consciously pushing all his team leads to deliver the best. The company's business is primarily dependent on the infrastructure projects of the government and government agencies since the share of the private sector entities has come down drastically over a period of time. Being a market leader, Tom & Tinken is able to withstand the pressure from the competition even though the margins are becoming thin.

Profile of the Finance Team

Mr. Vamsy Krishna is the Financial Controller who will be directly reporting to you and he has about 10 years of experience. He is a veteran in the company and has an indepth understanding of various business activities of the Company and the operating environment. He is a Cost & Management Accountant and also a Bachelor of Commerce from the Tagore University. He is supported by 2 Finance Managers, namely, Ms. Supraja and Ms. Sukanya who are Commerce Graduates specializing in Statutory Finance and Business Finance respectively. There are also 4 other Accountants and 6 executives supporting the Finance managers in their respective areas.

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Key Financial Highlights

Vamsy has informed you that a draft financial summary for the FY 2017-18 was prepared subject to certain pending items and the same was presented to the management and also to auditors. Key financial highlights as per such management accounts subject to certain open items are as under :

Particulars	FY 2017-18 Draft Unaudited/Provisional ₹ in crores	FY 2016-17 Audited ₹ in crores
Revenue From Operations	72,430	68,776
Other Income	344	213
Total Income	**72,774**	**68,989**
Operating Expenses+	61,288	52,348
Administration & Selling Expenses	4,333	1,455
Finance Cost	2,322	1,888
Depreciation*	2,876	2,487
Total Expenditure	**70,819**	**58,178**
Profit Before Tax	**1,955**	**10,811**

*Also includes amortization of Expenses of ₹ 22 crores.

+ Excludes GST paid and claimed as refund on certain eligible items amounting to ₹ 1254 crores.

Open Accounting Matters requiring resolution

Supraja and Sukanya, the Finance Managers summarized the following items which are open and are pending to be dealt with in the financial statements for your consideration. They already finished having a discussion with Vamsy and their views, were available, are also provided for your reference.

(a) An amount of ₹ 2.45 crores towards Accrual of certain liabilities relating to Refurbishment of certain spares meant for a specialized crane is yet to be made. The spares for refurbishment were sent in March 2018. Completion of the refurbishment/ receipt of spares by the Company is expected only in March 2019.

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(b) An amount of ₹ 4.35 crores relating to certain export benefits relating to export of construction machinery to Europe is yet to be accounted pending submission of export benefit documents with the concerned authority though the entitlement is more or less established.

(c) Certain employees are taken on a contract basis from a manpower service provider and the leave/gratuity liabilities calculated in accordance with the accounting standards relating to such employees are not accrued for in the financials of the company though contractually all the payments statutorily required to be made to such contract employees are to be borne by the company under the contractual terms entered into with the manpower service provider. The amount involved as at 31 March, 2018 is ₹ 2.44 crores.

(d) The stock option cost was not accounted under the Indian GAAP in prior years and the amount of fair value, if required, pending to be dealt with for FY 2017-18 is ₹ 1.46 crores.

(e) The amount of expected credit loss for doubtful receivables pending to be accounted as at 31 March, 2018 is ₹ 1.20 crores and the company intend to account it proportionately on a Straight line basis over the calendar year 2018 to spread the impact of the same. Further, no Expected Credit Loss (ECL) provision is considered for the Retention Receivables under the contractual terms, which, if determined, would be ₹ 0.75 crores as at 31 March, 2018.

(f) An amount of ₹ 0.50 crores committed to the political party as at 31 March, 2018 by the CEO, is pending to be accounted in view of the approvals required under the Companies Act, 2013.

(g) Certain foreign exchange payables are accounted using the forward rate instead of the closing spot rate as at 31 March, 2018. The impact of change required, if any, on recalculation under the spot rate basis would be ₹ 0.23 crores of exchange loss.

(h) An amount of ₹ 3.49 crores is adjusted against the Retained earnings directly as at 1 April, 2017 in view of the significant estimation difference relating to loss provision made for certain construction contracts pertaining to prior periods based on actual crystallizations in line with the accounting standard requirements.

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(i) An amount of Provision for losses relating to an ongoing Dam construction project at Goa amounting to ₹ 12 crores is considered for budget purposes in FY 2018-19 though the same is not included in the financial statements as at 31 March, 2018.

(j) Dividend Proposed for the FY 2017-18 is included as part of Finance Cost amounting to ₹ 1.2 crores.

Open Audit Issues requiring Resolution

Mr. Sai Ram, Partner from M/s. Jags & Raghav Associates met with you and briefed the following outstanding matters/ issues from the audit point of view :

(a) There is an issue with respect to using BOTS for the purpose of audits especially in the area of control testing. The Finance team of the Company has objected to the usage of such BOTS in the audit process and has not provided access to the data that is required for usage of BOTS for audit purposes.

(b) The original underlying documents/ vouchers are not available and only the scanned copies of the documents were made available for audit purposes. The audit team has requested for a visit to the scanning center at Manali which is yet to be organized. Vamsy strongly believes that such a visit/ verification of the originals is unwanted and is beyond the scope of statutory audit required under the Companies Act.

(c) The company has an internal Shared service center at Bengaluru and all the financial and accounting records for the entire Tom & Tinken Group across Asia, America, Africa and Gulf are maintained centrally and the processes followed are homogeneous in nature from a financial reporting angle. For the purpose of audit of the consolidated and stand alone financial statements of the group/ individual companies, the accounts team expects the auditors to follow a shared service approach of testing the homogeneous processes and controls and applying the conclusions to all the individual entities rather than testing it multiple times. The audit team has not accepted this view and the matter is pending resolution.

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(d) With respect to intercompany transactions between the Company and its international subsidiaries, the Arm's Length Pricing (ALP) principle of Transaction Net Margin Method (TNMM) is adopted from the Income Tax view point. The audit team has challenged this method and is insisting on a separate ALP for the purpose of reporting under the Companies Act since the requirement of evaluating the ALP for Companies Act is different from the Income Tax Act.

(e) The Audit team wants to send out the confirmation for a key vendor, namely, Glory and Gavy Limited who has a credit balance of ₹ 104.12 crores as at 31 March, 2018. However, Vamsy strongly objected to the same and has not agreed to send the balance confirmation. The reason for not sending the confirmation is primarily on account of certain disputes with the party which may get revived on sending such audit confirmations.

(f) In connection with 4 major contracts entered into during the year for which sizable margins are recognised, the audit team would like to use their engineering specialist for validating the assumptions relating to costs incurred, cost to come and the expected margins/ losses, if any, since such estimates are critical and would have a substantial impact on the results of the company. Supraja has objected to the same since the same was never done in the past and such an exercise would only delay the audit/ financial reporting and beyond the audit scope requirements.

(g) The Audit team would like to review the audit work papers of the previous auditors and has requested the company to facilitate the same. However, Sukanya strongly believes that no such practice is in vogue in India and the opening balances/ previous year audited financials can be presumed to be correct and the company will not entertain any such requests from the current auditors.

(h) Similarly the audit team wanted to review the books of account of the Joint Venture in Dubai which is audited by another auditor based out of Dubai. However, the finance team of the company is unable to facilitate/ support any such review by the parent company auditors.

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(i) The Audit Manager, Kodali Ashish Krishna has also put in a request to the Finance Team that the entire draft annual report of the Company may please be provided to them upfront before finalizing the same since they have to validate/ verify the same. However, Vamsy feels that the audit is required only for the financial statements and is not intended for the annual report which has various elements such as Directors Report, Management Discussion and Analysis, Corporate Governance Report, Financial Highlights etc. which are beyond the purview of statutory auditors.

(j) The audit team requested for a reconciliation of the transactions as per books with the details as per the Goods and Service Tax Network (GSTN) data w.r.t input credit, expenses accounted, income accounted etc. and also between the TDS credits taken and the interest income accounted as per books with the Form 26AS of the Company and also the reconciliation of profit between the costing records maintained for cost audit purposes with that of the financial records. Sukanya strongly believes that the audit is required only based on the books maintained by the company and there is no need to extend such audit to third party/ independent data maintained by the Regulators/ intended for different purposes.

(k) The Audit team has also highlighted various deficiencies, which are not material weaknesses, in the Procure to Pay process and has indicated its intention of qualifying the Internal Control over Financial Report to be issued on the financial statements as part of the audit report under the Companies Act.

(l) Sai Ram has also indicated that in the absence of all the details/ support required for finalizing the audits, he cannot issue the audit report and will also consider withdrawing the Review Reports issued on the quarterly financial information earlier based on Limited Review.

<u>Key Items of discussion with the Company Secretary</u>

Based on your discussion with Ms. Divya, Company Secretary, following matters requires your attention/action :

(a) The Audit Committee (AC) of the company has recommended referring an item relating to the whistle blower referral on one of the directors of the Company to an independent investigating agency which was over ruled by the Board of Directors. The same was concluded by the Board as frivolous complaint based on its own independent assessment.

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(b) One of the Directors of the company has recorded his dissent for approving the quarterly unaudited financial results of the company last time though the majority approved the unaudited financial results.

(c) A shareholder of the Company has sent a request to the company as well as to the auditor of the company seeking explanation on the provisions made for diminution in the value of investments which is pending disposal.

(d) The financial analysis details as provided to the analysts by the CEO with respect to various segmentation of the business is completely different from that of the segment disclosures made in the financial statements/ results and there has been several questions raised on the same.

(e) There is a request from a Foreign Institutional Investor (FII), who is a shareholder of the company to make the presentation made/ to be made by the statutory auditors to the AC/Board public.

(f) Further, Divya is also having apprehensions regarding various accounting matters and, hence, is evaluating the feasibility of not signing the statutory financial statements in view of the legal issues that could come up at a later point of time.

<u>Inputs from the CEO</u>

Prasanna Pai, the CEO has requested you to consider the treatment of following items :

(a) The amount of provision made for the diminution in the value of investments in the African Subsidiary amounting to ₹ 12.30 crores included as part of Administrative Expenses. He wants to explore the possibility of directly adjusting this against the reserves in the Balance Sheet considering that the same represents the write down of a capital investment.

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(b) Since the liquidity is a challenge for the company in the near future, the possibility of taking a short term borrowing from the bank for working capital purposes and using it for dividend distribution, if approved by the board/ shareholders.

(c) Certain amounts in the range of ₹ 4.30 Crores were not recognised in the financial statements as revenue in view of the uncertainties associated with the recognition in line with the accounting principles followed by the Company. He wants to explore the possibility of disclosing it somewhere in the financial statements so as to reflect the realistic picture.

(d) The amount of unclaimed liabilities of ₹ 1.97 Crores relating to employees who have left the company and the depositors who have not claimed for the past 10 years currently disclosed as part of liabilities may be written back to the Profit & loss account since the same was no longer payable.

(e) Providing Asset Retirement obligations on cash basis at actuals which has been accounted currently on estimation basis in line with the accounting policy followed by the Company.

(f) The possibility of presenting the financial results under the previous Indian GAAP (pre Ind AS) along with the Ind AS numbers in the financial statements for bench marking purposes.

You have to deal with the open accounting matters, address the audit concerns, deal with the issues raised by the Company secretary and also revert to the CEO of the Company on various matters raised by him. Please note that the financial statements of the company for the year under review are prepared using Ind AS for the first time.

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PART – A (2 Marks each)

Answer the following questions :

1.1 The amount to be accrued, if any, in connection with the refurbishment of spares as at 31 March 2018 referred to above is in the nature of :

A. Contingent Liability

B. Constructive Obligation

C. Construction Obligation

D. Crystalized Liability

1.2 Expected Credit Loss Provisioning (ECL) is not required for Retention Receivables arising out of contractual terms.

A. Not Correct since it is a financial asset / contract asset

B. Correct since it is a contract asset

C. Depends on the facts and circumstances

D. ECL is Not applicable for Infrastructure companies

1.3 Difference between estimate and the actual relating to the prior periods would be considered as a prior period adjustment under IND AS :

A. Yes, based on matching Principle

B. No, actualisations of estimate difference are period adjustments in Profit & Loss Account

C. Depends on the outcome of evaluation of differences by the Board

D. Depends on the nature of the item requiring estimation

1.4 Board has the power to overrule the decisions of the Audit Committee (AC) under the Indian Companies Act, 2013 :

A. No

B. Yes, after informing the Regulator

C. Yes, but disclosure need to be made with reasons therefor in the Board Report

D. Would vary based on the nature of the decisions of the AC and the profile of the AC Chair

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1.5 Auditor of the Company is having an obligation to validate all the financial and non-financial information provided along with the audited financial statements as part of the Annual Report

A. Yes, as required under the Auditing Standards

B. No, it is only voluntary on the part of the auditors

C. Limited to financial information only

D. Yes, to the extent it related to the relevant Information not reported as part of the financial statements.

1.6 Company Secretary is equally responsible for ensuring compliance with the accounting standards and other reporting requirements relating to the financial statements under the Indian Companies Act, 2013 similar to that of the CFO

A. Yes, it is demonstrated by his requirement to sign the financial statements where required

B. No

C. Yes, for listed Companies

D. Depends on the decision of the Board

1.7 The Company and the Auditor is duty bound to provide the information required by the shareholders at any time.

A. No

B. Company is responsible but not the auditor as per the requirements of the Companies Act, 2013

C. Auditor is responsible but not the Company as per the requirements of the Companies Act, 2013

D. Yes, both are responsible under the Companies Act, 2013

1.8 All deficiencies irrespective of its nature, as identified by the auditors relating to internal control over financial reporting, would need to be reported appropriately as part of their audit report to the shareholders under the Companies Act, 2013

A. Yes, material weaknesses, significant deficiencies and other deficiencies need to be included as part of the audit report to the shareholders.

B. Yes to the extent approved by the AC/Board.

C. Nothing needs to be reported to the shareholders.

D. Deficiencies which are material weaknesses need to be considered suitably for reporting to the shareholders.

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1.9 Auditee can decide on the nature/ extent of the audit procedures required to be carried out by the statutory Auditors in connection with the audit of the financial statements under the Indian Companies Act, 2013

A. No

B. Yes, with the approval of the shareholders

C. Yes, since the company appoints the statutory Auditor

D. Depends on the facts and circumstances

1.10 Any additional information as determined by the management can be provided as part of the financial statements over and above the minimum disclosure requirements stipulated under the Indian Companies Act, 2013.

A. Strictly No, since the disclosure requirements are mandated under the Indian Companies Act, 2013

B. Yes always, as long as the minimum / stipulated disclosure requirements are complied with

C. Can be discussed and decided based on the mutual consent of the auditor and the auditee

D. Yes, provided the same is required for better understanding of the financial statements.

PART – B

Answer the following :

1.11 What will be your response to the Statutory Auditors regarding various matters highlighted by them as part of the audit process ? **12**

1.12 Based on your review of the aforesaid case, Analyse the various adjustments & also items which do not require any adjustments in your view, to the draft financial statements of the company. **6**

1.13 How will you deal with the issues raised by the company secretary from the financial reporting and compliance perspective ? **6**

1.14 What will be your response to the CEO on his proposals regarding various matters and explain the basis for your conclusion. **6**

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QUESTION NO : II

You are the leading Consultant, advising companies with respect to various compliance related matters impacting their operations in India. In particular, your primary focus is on Direct /indirect Taxes, Economic Laws and Corporate Laws. Your clients are spread across the country and you have a large team of professionals working under you supporting your entire advisory practice.

<u>Introduction</u>

Ringing Bell Group based out of Singapore has a Liaison Office (LO) in Mumbai and currently has very limited operations in India. The Group specializes in the area of developing 3 D Printing capabilities and is fast growing in this segment globally. The Indian LO, at present, employs about 40 people primarily to represent the parent in dealing with the customers in India. The group is well recognised for its governance standards and is very keen to implement its zero tolerance for Non-compliances policy.

The Chief Executive Officer of the Group, Mr. Jim, has visited India recently and has identified India as a core market for the group's global growth and is very keen to develop the Indian operations of the group significantly. Considering the complex regulatory set up in India, he wants to ensure that the growth plans does not result in regulatory non-compliances having an impact on the group's brand image. He has asked his Chief Compliance Officer, Mr. Thompson to visit India and give him a report on the applicability of various aspects including the current state of affairs, compliance standards, and regulatory hygiene assessment and also on the various laws and regulations which may potentially have an impact for Ringing Bell duly considering its business plans for India.

The financial controller who manages finance as well compliance for the Ringing Bell, India's LO operations, Mr. Ram Kumar has requested you, as an independent consultant, to assist Thompson in his mission, who is on a business visit to Mumbai.

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You have accepted this offer and meeting Thompson and Ram Kumar in their Office at Navi Mumbai with your colleagues, Mr. Hari, Manager Taxation and Mr. Porus, Director, Economic & Corporate Laws.

Overview of Significant Laws impacting Ringing Bell, India

In the meeting, Ramkumar gave an overview of the Indian Companies Act, Income Tax Act, GST Act and other Economic Laws at a high level to the extent relevant for the current operations of the Indian LO and also presented the financial state of affairs of the Indian entity. Thompson explained the group's plans for focusing on the Indian market more vigorously and wanted to understand the overall regulatory reforms in the country.

You have highlighted to Thompson that India is embarked on a journey of simplifying the complex regulatory set up and is committed to Ease of Doing Business. In addition, you have also highlighted that whilst every effort is made to simplify the laws, the penalties for non-compliances have been made more severe and hence at most care has to be taken in ensuring due compliance with all the applicable laws and regulations.

Thompson was very keen to understand the regulatory environment including the litigation settlement process especially the time taken for disposal of cases by the judiciary. The various discussion points/ questions raised/ clarifications sought are summarised below for your consideration.

Questions on the Income Tax Related Aspects

Thompson expressed his intention to understand the Taxation aspects relating to Indian Entities. In particular, he was very keen on understanding the transfer pricing provisions relating to transactions with the group companies. His specific clarifications on Transfer Pricing relate to the following :

(1) Whether the transfer pricing policy followed by the group globally would be acceptable to Indian Income Tax authorities ?

(2) Is there a mechanism to get that understanding confirmed upfront to avoid legal battles at a later stage ?

(3) Is there a requirement to apply different yardsticks for evaluating the transfer pricing from different laws other than the Income Tax Act ?

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Thompson was also very keen to understand the implications of GAAR under the Income Tax Act. Hari, Manager Taxation has explained the provisions of GAAR under the Indian Income Tax Act, which needs to be duly considered in evaluating the relevant transactions from the tax angle.

Thompson was also interested in understanding the difference between tax planning and tax evasion given the complexity of the Indian income tax laws. Ram Kumar indicated that both look alike and he also raised some specific issues which may be clarified in this regard. The issues raised by Ram Kumar on this aspect are summarised below :

(1) Setting up their Unit in a Special Economic Zone and claiming tax exemption and the implications of the same under the applicable provisions in the Income Tax Act.

(2) Requesting the Supplier of the Group based out of Singapore to provide a loan to the Indian entity of the group from its shell/ loss making subsidiary in India at a higher rate of interest for claiming tax deduction for interest and adjusting this at the group level as part of overall price negotiation by the parent

(3) Declaring dividend based on the applicable provisions of the income tax rate only when it is favourable not with standing the availability of adequate profits in the financial year.

(4) Providing rebates and discounts to channel partners who are customers of the Company instead of sales incentives and not withholding the taxes.

Thompson was also keen in understanding tax aspects relating to payment of royalty on patents developed and registered in India. He was curious to know the applicable tax rates on such payments.

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<u>Clarifications on Foreign Exchange Transactions</u>

Thompson was inquiring about the Foreign Exchange Regulations as applicable for their proposed Indian operations and sought your clarifications on the following aspects :

- Carrying out large scale business activities using the existing LO model.
- Possibility of exporting from India to its various customers in Europe and requirements relating to receipt of money especially time limits, if any and other compliances involved in connection with the non-realizations.
- Procedural aspects relating to funding the Indian entity through external commercial borrowings/advance from the parent against future supplies.
- Possibility of arranging for remittance of funds on exports made by the Indian entity to various customers by the parent directly for ensuring administrative convenience.

Ram Kumar explained that the proposed Indian operations would also require import of certain capital assets from its parent. He inquired about the accounting and tax implications of possible waiver of liabilities relating to payable to the group companies in Singapore arising out of supply of capital goods to the Indian entity as an indirect funding mechanism. He was also wondering whether such capital assets could be supplied to Indian entity at free of cost and what would be the accounting/tax requirements relating to the same ?

Thomson was concerned about the definition of the term "Hawala" under Indian laws and the implications for the Key Managerial Personnel of the Company on such Hawala transactions, if any. He wanted to understand the same in detail and in particular the difference between Hawala and Round Tripping.

Thompson was also curious to understand the requirement relating to donating certain amounts from Singapore as part of their group Corporate Social Responsibility (CSR) commitment to the Indian entity which can be used for various charitable purposes/welfare measures in India. This would go a long way in building their brand in India.

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Porus, explained that whilst the provisions of the foreign exchange regulations have been simplified substantially from the "Control based approach" to "Management based approach", a thorough evaluation of the various foreign currency transactions would be absolutely essential for ensuring zero non-compliance.

Issues on Recovery and Legal Protection Mechanism

Ramkumar raised the issues of legal remedies available in India for recovering amounts rightfully due to the Company, in case of default by the customer. He was curious to understand the provisions relating to the Insolvency and bankruptcy code, 2016 which would come in handy for enforcing timely actions by the defaulting customers, where required.

He also wanted to understand how the settlement of the dues would be prioritized as compared to various secured creditors of the defaulting company at the time of insolvency. Further he was keen to understand the deductibility of provisions made for bad and doubtful receivables under the Indian Income Tax Act.

Corporate Law Implications

Ram Kumar suggested that it would be better to incorporate a company for the purpose of business expansion. Thompson wanted to understand the need for such a new corporate set up and if required, the statutory audit requirements, if any, relating to the existing LO and the new corporate set up.

Thompson wanted to find out if there is any mandatory requirement to appoint the independent Director for the subsidiary, which if incorporated, would be a closely held company of Ringing Bell, Singapore. He was also keen to find out the compliances relating to notices of the board meetings to be sent to directors, including the directors residing in foreign countries and the timelines indicated, if any, under the Companies Act, 2013.

Ram Kumar raised the issue that compliance requirements relating to Related Party transactions under the Companies Act would be very complicated. Thompson wanted to understand the same in detail and in particular, aspects relating to compliance reporting requirements, when the relationship is structured in such a way that it ceases to exist, of course, within the legal framework!

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Thompson also wants your inputs on the following specific aspects under the Indian Companies Act, 2013:

- Need for setting up a compliance and governance committee
- Compliance audit
- Roles and Responsibilities of the Directors for Compliance with laws and Regulations
- Immunity available to Directors of the Company for Ignorance of laws/professional indemnity

He was wondering whether statutory auditors would give him comfort on the compliance requirements and what would be the role and the responsibility of the statutory auditors on this matter under the auditing standards prevailing in India as referred to under the Indian Companies Act.

Asks from You

You are requested to advise Ringing Bell based on your understanding of their requirements, issues, if any, and clarifications sought. Please make relevant assumptions as may be required to explain your answer so as to provide a holistic and relevant feedback. Your response would be very vital for the group's decision to expand the Indian operations and hence the group is expecting your best advice!

PART – A **(2 Marks each)**

Answer the following questions :

2.1 In responding to Thompson, you have explained that under Hawala System

A. Money exits the Hawala system in local currency and enters as foreign currency

B. Money enters the Hawala system in foreign currency and also in local currency

C. Money enters the Hawala system in local currency and leaves as foreign currency

D. Money exits the Hawala system in foreign currency and also in local currency

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2.2 In your role as an advisor to Ringing Bell, you will indicate to them that under the provisions of the Companies Act, 2013, a notice of the Board meeting must be served to :

A. All the directors except to an interested Director.

B. All the directors except to a Director who has expressed his inability to attend a Board Meeting.

C. All the directors, except a person who has gone abroad (for less than 3 months).

D. All the Directors.

2.3 Write off of Foreign Exchange receivables arising out export sales of Ringing Bell is permissible

A. No, it is not allowed

B. Yes, it can be done through credit notes by reversal of export sales subsequently

C. Only with the approval of the Authorized Dealer

D. Only in compliance with the FEMA/ RBI Guidelines

2.4 Assume that one of the group companies of Ringing Bell, Singapore rendered certain services to its Indian entity for the first quarter ending 30 June 2019 and after that the related party relationship does not exist under the Companies Act, 2013 due to certain reorganisation at the group level. If such services were rendered to the Indian entity for the whole year like any other ordinary customer

A. The transactions for the whole year must be disclosed as related party transaction.

B. The transactions for the first quarter ending 30 June, 2019 alone should be disclosed as related party transactions

C. Since the transactions were only for the first quarter and not for the whole year, no disclosure is required to be made

D. Only the transactions other than the 1st quarter ending 30 June, 2019 should be disclosed as related party transactions.

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2.5 Ringing Bell can carry out export business activities with commercial arrangements in India directly through their LOs indefinitely without having any legal requirement to incorporate a domestic setup

A. Yes, it is permissible under Ease of Doing Business Guidelines.

B. No, since the LOs are not permitted to be engaged in income generation activities.

C. Allowed with the approval of the RBI if the parent company is located in any of the SAARC countries.

D. Will be decided by the DGFT on a case to case basis after obtaining the clearance from the Income Tax Authorities and the Authorized Dealer.

2.6 Liabilities arising out supply of capital goods by the foreign parent company to Ringing Bell and written back subsequently based on the waiver letter from the parent;

A. Can be taken to other income with the approval from the Authorized Dealer

B. No accounting is required; only intimation to the RBI is intended

C. To be netted against the cost of the capital asset and no RBI approvals are required for the same.

D. To be adjusted against opening Retained Earnings and approval from the RBI and the appropriate authority in the foreign jurisdiction is required.

2.7 Amounts Receivable from the Foreign Party towards supply of goods or services by Ringing Bell and remaining as outstanding (in excess of the stipulated thresholds for *suo moto* writeoff) and considered as doubtful of recovery

A. To be continued to be treated as good till such time the approval from the RBI/AD is obtained for write off

B. Can be written off in the accounts and claimed as an allowable expense for taxation purposes and the procedural aspects of approvals from the RBI/AD may be obtained later.

C. Provided for in the accounts towards doubtful receivables, disallowed for income tax computation purposes and the write off to be effected in compliance with the FEMA/RBI directions and income tax requirements.

D. Will remain in the books for ever and nothing needs to be done.

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2.8 Under the Indian Insolvency and Bankruptcy code, 2016, Ringing Bell - India can initiate action against the defaulting companies in India for non-payment of its enforceable dues;

A. For any amounts in excess of USD 100 in its capacity as financial creditor

B. For any amounts in excess of ₹ 100 in its capacity as corporate debtor

C. For any amounts in excess of ₹ 0.1 Million with the approval of NCLT

D. For any amounts in excess of ₹ 0.1 Million without the approval of NCLT

2.9 Arm's Length Principle (ALP) established under the various legal requirements in India would be the same;

A. Yes, it cannot be different for different purposes

B. No, it can be different for different purposes as stipulated under the legal provisions.

C. Depends on the facts and circumstances and the nature and the type of the entity

D. The Central Government has the authority to establish the ALP which can either be the same or different under different laws.

2.10 Compliance Audit of applicable laws and regulations is mandatory for all companies registered under the Indian Companies Act, 2013

A. Yes, for All Companies registered under the Companies Act, 2013

B. No, It is applicable only for companies investigated by the SFIO under the Companies Act, 2013

C. It is part of the Internal Audit mandatorily stipulated under the Companies Act, 2013

D. Compliance Audit is not specifically mandated for all companies under the Indian Companies Act, 2013

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PART – B

Answer the following :

2.11 What would be your advice to Ringing Bell in developing a framework for ensuring compliance with laws and regulations in India ? **4**

2.12 You are requested to provide detailed responses to the 3 specific clarifications sought by Thompson in connection with the Transfer Pricing aspects under the Indian regulatory requirements. **6**

2.13 Explain the difference between Tax Planning and Tax Evasion using the 4 specific issues raised by Ramkumar. **4**

2.14 What would be your response to Thompson regarding the specific requirements of the Indian Companies Act, 2013 relating to **8**

- Need for setting up a compliance and governance committee
- Compliance audit
- Roles and Responsibilities of the Directors for Compliance with laws and Regulations
- Immunity available to Directors of the Company for Ignorance of laws/ professional indemnity

2.15 What is the role and the responsibility of the statutory auditors in connection with the laws and regulations under the applicable auditing standards in India/ Indian Companies Act, 2013 ? **4**

2.16 What do you understand by the term Round Tripping under the Tax laws and explain the same with an example. **4**

QUESTION NO : III

You are the well-known Corporate Guru specializing in assisting companies in carrying out business valuations, due diligences and providing various transactional advisory services including the Risk assessment for corporates. Your clients are typically start-up companies which are looking for capital infusion/ advice and support in building their core operational and governance model.

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Ding Dong Ventures is a Private Equity (PE) fund which specializes in funding the startups in the area of E- commerce. They have reached out to you to help them in carrying out the Risk assessment, due diligence and also a business valuation of one of their targets, namely, Quick & Qual Sys Limited specializing in developing innovative last mile connectivity products to facilitate seamless delivery of retail products quickly and efficiently. Ms. Harini, the Managing Partner of Ding Dong Ventures introduced you to Mr. Ramaswamy, the promoter and the Managing Director of Quick & Qual Sys Limited and also to Mr. Sarvesh, the Chief Finance Officer of Quick & Qual Sys Limited. They have given you an overview of the Company and the business along with the various financial metrics for your perusal.

Company Overview

The company is promoted 5 years back by Ramaswamy in Pune. It commenced its commercial operations after a year of incorporation after augmenting the sizable capital and debt. It has grown in its size steadily. Currently it has 80 employees located primarily in Pune. Mr. Frederick is the Chief Operating Officer and Mr. Naveen is the Chief Strategy Officer of the Company who have joined hands with Ramaswamy in expanding the operations of the Company. Sarvesh, the Chief Financial Officer of the Company joined recently and has the experience of taking couple of startups for listing in the past.

Business Outlook

The strategic focus of the Company is to get listed in the Indian Stock market in the next 5 years of time. The management believes that with the rapid growth in the E- commerce space, the need for developing a viable solution for the last mile connectivity using the power of technology and the knowledge of the Indian customer would be absolutely critical. The company is also embarked on a journey of using artificial intelligence for responding to the requests of the major E- commerce players in bringing a holistic technology network platform. It is expected that in the next few years with the considerable liberalization in the foreign investment policy, several global players are expected to target the Indian market and, hence, the market is going to grow exponentially. It is worth noting that the Company spends about 10% of the profits for innovation.

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The company's continued business success depends on the support provided by 2 of its major customers namely Gamazon and Blip Kart though there are other innumerable small volume customers. The market share put together from these 2 customers is expected to be around 27% in the last year. Further, the company is also dependent on the continued support from its core employees, who are categorized as Platinum Players, numbering 10. Whilst every effort is made for rewarding these employees suitably with stock options and other monetary benefits, the chances of them leaving the company and joining the competition are very high.

Competition Landscape

There are several players who have entered this space due to the renewed interest evinced by the foreign players in the Indian E-commerce business. Whilst the craze is noticeable, there are only handful of viable competitors to Quick & Qual Sys, namely. Humble Honey Bee Solutions and Golmart Global Solutions who are also having a similar volume of operations and the business outlook. Humble Honey Bee Solution was valued at USD 12.50 Million recently for its second round of PE funding whereas Golmart is yet to raise funds from third parties and is solely managed by promoter funding at present.

Financial Overview

Sarvesh has presented a detailed strategic profitability analysis of the Company. During the presentation, several questions were raised on various aspects including the growth, profitability, sensitivity analysis of price trends, impact of forex fluctuations on the operations of the company, sustainability aspects etc.

An analysis of the operating income for 2017 and 2018 is given below :

(Amount in ₹)

Particulars	**Amount as per P&L in 2017**	**Revenue and Cost Effect of Growth component in 2018**	**Cost and Revenue Effect of Price Recovery Component in 2018**	**Cost Effect of Productivity Component in 2018**	**Amount as per P&L in 2018**
Revenue	4,60,08,571	21,00,000	43,00,000	–	5,24,08,571
Cost	2,85,00,000	6,00,000	25,60,000	(6,80,000)	3,09,80,000
Operating Income*	1,75,08,571	15,00,000	17,40,000	6,80,000	2,14,28,571

*Represents profit before tax

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Company added 300 and 500 customers in 2017 and 2018 respectively by focusing more on the client base rather than on the value of the revenue generated from each and every customer. During 2018, the E-commerce market has registered a general growth of about 10% in terms of number of customers and all other changes are due to the company's differentiation cum marketing strategy and the productivity based efficiencies brought into operations due to innovations.

The customers of the company are primarily located in India. Whilst the company has several domestic borrowings, it has also borrowed through Forex Tech Fund channel, an amount of USD 5,00,000 where the rate of interest is pegged at 5% flat. The loan was taken when the USD was at 1 USD - ₹ 61 and the company expects that there will not be any wide variation when the loan is to be settled after a period of 4 years and, hence, has not taken any forward/ swap for covering the forex fluctuations.

<u>Business Case for Funding</u>

Quick & Qual Sys has recently registered its name convincingly in the investor community through their endorsement by the E- Commerce World Association as Rising Star! In addition, it also has got favourable reviews from several Analysts in this space who are watching their marketing strategy and the customer penetration style closely. Several PEs including Ding Dong has evinced keen interest in building a relationship with Quick & Qual Sys.

Naveen presented an overview of the business case for funding by Ding Dong and provided various vital information based on his assessment. He indicated that for fueling the growth in the business, adequate capital infusion would be required given the ongoing technological disruptions.

He has indicated that for business valuation purposes, there is no point in using asset based valuation model which will not be suitable for such high potential E-commerce startups since the model has several drawbacks. He said that he would not entertain any valuation exercise based on such models. He suggested that any business valuation needs to be "Forward looking" duly considering the income generating potential of the entity on a sustainable basis.

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He added that the average cost of debt for the company is about 11% and the tax rate can be presumed to be around 30%. The Company has an EBITDA of ₹ 26,453,571 for FY 2017-18 and the leverage beta based on E-commerce industry is 2.3 which is 0.86 less than the unlevered Beta. The average Equity-Debt ratio is about 70:30. The rate of return provided by highly liquid bonds is around 4%. The Enterprise value is pegged at a multiple of 3 on EBIDTA. The E-commerce industry generally expects a market return of about 8% as per the recent research report published by Gartners. Free Cash flow for the next 3 years is expected to be flat at about ₹ 19,300,000. The value arrived based on Relative Valuation technique is around ₹ 53 Million.

You wanted the details of EBIDTA and noted the following on perusal :

- An amount of ₹ 5.5 Million has been taken as intangible asset which represents the management derived salary cost equivalent of time spent by the senior management in building innovative E-commerce platforms. There is nothing specific which can be identified specifically as an intangible item.
- An amount of ₹ 3 Million has been accrued towards unbilled revenue which remains unbilled for over 18 months and the same represents the additional amounts claimed by the company which is challenged by the customer.
- An amount of ₹ 2 Million, including ₹ 0.45 Million of GST towards sales promotion expenses for which no input credit was availed/eligible, has been considered as deferred revenue expenditure where the such promotion expenses incurred by the company is expected to yield benefits over the next 2 years excluding 2018.
- An amount of ₹ 6 Million has been paid to Ramaswamy towards his salary cost for the services rendered by him to the Company even though the comparable startups would pay roughly 50% of the amounts paid by the Company.

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The Chief Finance Officer, Sarvesh indicated that the Capital Asset Pricing Model (CAPM) could also be considered for evaluating the risks attached and the returns expected from the investors view point which will make the investment in the company very attractive.

Harini wanted to have an idea on the Economic Value Added (EVA) by the Company for which Sarvesh responded that the same could be derived based on the information already made available to Ding Dong and no further details are required to compute the same.

To a specific query raised by you on abnormal costs, if any, identified by the management, Sarvesh responded that he is not aware of any such things under the Cost Accounting Standards though he was unsure of the applicability of the same to the Company.

PE Expectations

Post your introduction meeting with Quick & Qual Sys, Harini of Ding Dong explained her expectations from you and gave the following additional inputs.

The company has a Company Secretary who also acts as a compliance officer. Being a promoter driven set up which has transformed in the last 2 years more rapidly, the company is putting in place a robust platform for strengthening the compliance controls. The promoter, Ramaswamy was banned by SEBI in the past in connection with the trading in shares by using the insider information for a period of 3 years in 2006. He has come out of this ban now and has repositioned himself as an Emerging Business Magnet with this Startup venture. Further, he is also a director in another Company unrelated to Quick & Qual Sys, namely. Wine and Wonder Limited which did not file the financial statements for the years ended 31 March 2016 and 2017 and did not pay interest on loans taken from a public financial institution from 1 April 2017. However, it has promptly repaid matured deposits taken from public on due dates.

The company currently uses Tally for its accounting and operational book keeping purposes. Cheques are signed by the Chief Financial Officer only as a single signatory. The company does not have any system of organizational hierarchy from the finance view point and is taking this up as a key priority for FY 2019.

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Harini has indicated that they are very excited to pursue this investment opportunity and hence apart from the Risk assessment, Due Diligence and Business Valuation to be carried out by you, she wants to assess the Value at Risk (VAR) for the proposed investment of Ding Dong. She was also keen to understand the implications of using Gordons Model for assessing the value potential of similar E- Commerce companies in the startup space. She is also open to consider Leveraged Buyout options, if the same is found to be more attractive and needs your inputs on the same as well.

You are requested to critically evaluate the Business Case presented by Quick & Qual Sys and provide your inputs to help Ding Dong in making their investment decision. Please note that Ding Dong would present your findings and the responses provided by you for the various clarifications/questions directly to their investment committee based out of New York and hence you need to put in your best in meeting the stakeholders expectations!

Good luck....!

PART – A **(2 Marks each)**

Answer the following questions :

3.1 As indicated by Harini of Ding Dong, the concept of VAR can be applied

A. For Business valuations

B. For Goodwill valuations

C. For using as a tool for asset/ liability management

D. For deriving Beta variable

3.2 Adjusted EBIDTA to be considered for business valuation of Quick & Qual Sys is ₹ :

A. 12,953,571

B. 15,953,571

C. 14,953,571

D. 26,453,571

3.3 Gordon Model of valuation can be applied to Quick & Qual Sys

A. Yes, it is widely used by PEs since it is practical

B. No, it is Rarely used by PEs since it is theoretical

C. No, It is used only when the entities plough back the profits

D. No, it is used only when the entities declare dividends continuously

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3.4 The concept of Equity Value and the Enterprise Value for Quick & Qual Sys

A. is different

B. is one and the same

C. depends on the purpose of valuation

D. Not applicable since it operates in E- commerce space

3.5 The concept of EVA referred to by Harini

A. Is derived based on the expected value addition using the value at risk

B. Is derived based on surplus of returns over the capital charge

C. Is derived based on PBT and the Beta attached to the business

D. Is derived based on deficit of returns over the capital charge

3.6 Leveraged Buyout Option based investment model proposed by Ding Dong envisages

A. Long Term Business based investment through Equity

B. Clever Mix of Debt and Equity and leveraging on the debt to create value

C. Funding through Long Term Debt focused on high yields

D. Investing through creeping acquisitions of Equity based on Business growth

3.7 Horizon Value typically considered in business valuations represents

A. The value of the business derived based on Free Cash Flow

B. The value the investor will forecast for valuing the investment at the exit point

C. The value of the business derived using the perpetual growth model

D. The value the buyer is willing to pay at the end of the negotiation

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3.8 The Capital Assets Pricing Model for valuing Quick and Qual Sys is to be developed based on the principle of

A. Valuing the investment returns based on indirect benefit of assuming risks

B. Valuing the investment returns based on the direct benefit of assuming risks

C. Valuing investment returns using the hybrid model of capital and assets deployed

D. Valuing investment returns using the sales pricing model and Beta.

3.9 Strategic Profitability Analysis presented by Sarvesh for Quick & Qual Sys is carried out using the

A. Standard Cost, Margin Analysis, Product Profitability

B. Marginal Cost Recovered, Fixed Costs, Product Mix

C. Strategic Objectives, Profit Component, Cost Component

D. Growth Component, Price Recovery Component and the Productivity Component.

3.10 In view of the provisions of the Companies Act, 2013, duly considering the aspects relating to non-compliances associated with Wine & Wonder Limited, promoter Director of Quick & Qual Sys, Mr. Ramaswamy is ;

A. Disqualified to continue as a Director in. Quick & Qual Sys

B. Disqualified to continue as a Director in Wine & Wonder.

C. Disqualified to continue as a Director in Quick & Qual Sys as well as Wine & Wonder.

D. Not Disqualified and hence he can continue as a Director of Quick & Qual Sys and Wine & Wonder.

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PART – B

Answer the following :

3.11 How would you rate Quick & Qual Sys based on the information provided and elucidate various positive and negative aspects that needs to be considered in the overall evaluation of the investment by Ding Dong ? **5**

3.12 You are required to identify different types of Risks faced by Quick & Qual Sys and also assess the Risks critically to facilitate investment decision by Ding Dong. **7**

3.13 Prepare a Buildup statement of Operating Income of Quick & Qual Sys by taking 2017 as a base and arrive at 2018 operating income by deriving the extent of change in operating income from 2017 to 2018 due to the industry market size factor, productivity and product differentiation. **5**

3.14 Based on the Business Case details provided by Quick & Qual Sys, what would be the potential value that can be placed for the Company ? **7**

3.15 What is the difference between Risk Assessment, Due Diligence and Valuation exercises which you need to carry out on behalf of Ding Dong in connection with their potential investment in Quick & Qual Sys and how are they inter related ? **6**

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